TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1927

No. 201

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION OF THE COMMONWEALTH OF MASSACHUSETTS, PETITIONER,

vs.

GEORGE I. ROCKWOOD

No. 202

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION OF THE COMMONWEALTH OF MASSACHUSETTS, PETITIONER,

vs.

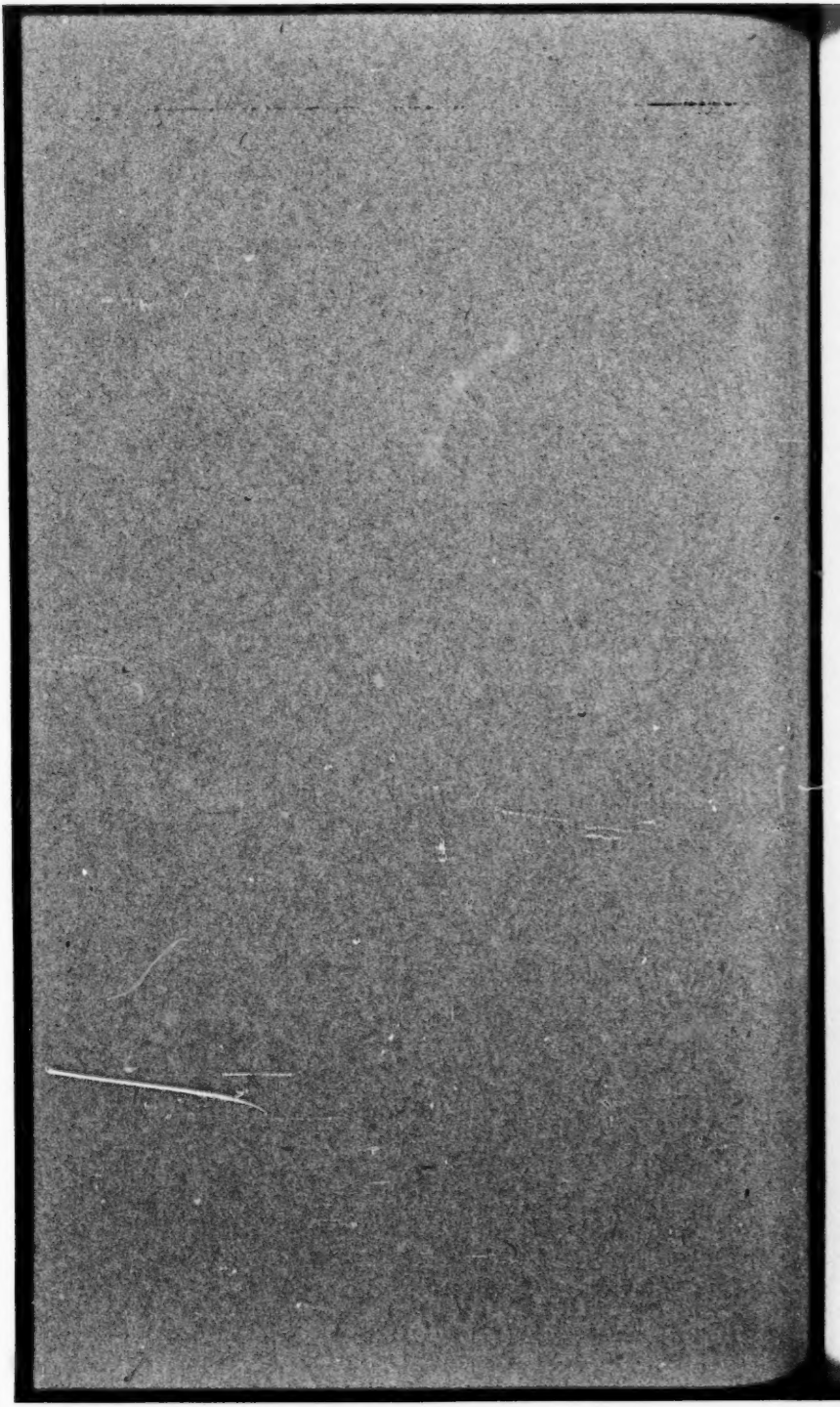
GEORGE I. ROCKWOOD

ON WRITS OF CERTIORARI TO THE SUPERIOR COURT FOR THE COUNTY OF WORCESTER, STATE OF MASSACHUSETTS

PETITION FOR CERTIORARI FILED MARCH 24, 1927

CERTIORARI GRANTED APRIL 25, 1927

(32,560, 32,561)



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SUPREME COURT OF THE UNITED STATES

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ON PETITION FOR WRITS OF CERTIORARI TO THE SUPERIOR COURT OF THE STATE OF MASSACHUSETTS FOR THE COUNTY OF WORCESTER

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[fol. 1] COMMONWEALTH OF MASSACHUSETTS:

IN SUPERIOR COURT OF WORCESTER COUNTY

No. 27819

GEORGE I. ROCKWOOD

vs.

HENRY F. LONG, Commissioner of Corporations and Taxation

BILL OF EXCEPTIONS AND ORDER ALLOWING SAME—Filed November 11, 1925

This is a complaint and appeal under G. L., c. 62, § 47, from the refusal of the defendant to abate an additional income tax for the year 1922 on income received during the year 1921. The complaint and defendant's answer thereto are hereby made a part of this bill of exceptions. The case was referred to a commissioner to hear the parties and report the facts. The commissioner's report is hereby made a part of this bill of exceptions. The case was then heard by Mr. Justice McLaughlin on the commissioner's report and upon certain documents, copies of which are hereto attached marked Exhibits "A" and "B." Thereafter the court made findings and rulings as shown by a memorandum thereof, which is hereby made a part of this bill of exceptions.

At the hearing before the court the defendant duly presented the following requests for rulings:

"1. Income from royalties received for the use of patents issued by the United States to the taxpayer upon inventions made by him is taxable as business income under G. L., c. 62, § 5(b), as amended.

2. Income from royalties received by the complainant from the Rockwood Sprinkler Company, upon the facts reported by the commissioner, was properly assessed to the complainant by the Commissioner of Corporations and Tax-

ation under G. L., c. 62, § 37, as amended, as business income taxable under G. L., c. 62, § 5(b), as amended.

3. Income credited to the taxpayer upon an open or running account subject to be drawn by him at any time is income received by him under G. L., c. 62, § 5, as amended, although such income is not computed upon a basis other than actual cash receipts.

4. Income from royalties received by the complainant from the Rockwood Sprinkler Company was received by him, upon the facts reported by the commissioner, when it was actually credited to his account upon the books of the company.

5. An allowance for depreciation in the value of patents of the United States secured by the taxpayer upon inventions made by him, based upon the actual cost of securing such patents, may be a reasonable allowance under G. L., c. 62, § 6(b), as amended, although the value at the beginning of the year is greater than the cost.

6. The allowance by the Commissioner of Corporations and Taxation for depreciation in the value of the patents [fol. 2] referred to in the complaint, upon the facts reported by the commissioner, on the basis of the actual cost of securing such patents, was a reasonable allowance under G. L., c. 62, § 6(b), as amended."

The defendant seasonably excepted to the rulings of the court and his failure to rule by filing in the clerk's office the following written statements:

"Exceptions to Rulings

The defendant within three days after the receipt of notice from the clerk of the rulings and decision of the court in the above-entitled case hereby takes the following exceptions thereto.

1. The defendant excepts to the ruling on the findings of the Commissioner that in this case the income from the royalties was not income from business and was not taxable.

2. The defendant excepts to the decision hereinabove referred to."

"Defendant's Exception to Failure to Rule

The defendant within three days after the receipt of notice from the clerk of the rulings and decision of the court in the above-entitled case hereby excepts to the failure of the court in his decision to give rulings numbered 1, 2, 3, 4, 5 and 6, requested by the defendant."

Wherefore, being aggrieved by the rulings and decision of the court as hereinabove stated, the defendant brings this his bill of exceptions and prays that the same may be allowed.

Henry F. Long, Commissioner of Corporations and Taxation, by Alexander Lincoln, Assistant Attorney General.

Exceptions allowed. John D. McLaughlin, J. S. C.

Filed Nov. 11, 1925.

(For Exhibits "A" and "B" see copies attached to this record.)

In Superior Court of Worcester County

Bill of Complaint and Order to Notify Defendant—
Filed February 28, 1924

(Filed under Section 47, Chapter 62, of the General Laws as amended by Chapter 113, General Acts of 1921 as further amended by Chapter 287, General Acts 1923.)

Respectfully George I. Rockwood brings and files this complaint against Henry F. Long, as he is duly constituted Commissioner of Corporations and Taxation of the Commonwealth of Massachusetts, and as grounds for said complaint, alleges as follows:

[fol. 3] One. That he was on and prior to January 1, 1921 and has been since that date, and still is a citizen of said Commonwealth and resident of Worcester, in the County of Worcester and said Commonwealth, maintaining also at said Worcester his principal place of business.

Two. That pursuant to the provisions of Chapter 62 of the General Laws and acts amendatory thereof and in addition thereto, complainant on or before March 1, 1922 did duly file an income tax return with the Income Tax Division of respondent's department, fully making known therein items of income received by him during the calendar year 1921 and subsequent thereto the respondent did assess and the complainant did pay an income tax for the year 1922 based upon said return.

Three. That during the year 1923 the respondent Commissioner acting under and pursuant to the provisions of Section 37 of said Chapter 62, and acts amendatory thereof and in addition thereto, did claim to find by verification of said return that the income of the complainant for the year subject to taxation under said Chapter 62 or some portion thereof had not been assessed, and did thereupon and thereafter assess the same; at the same time similarly acting under said section in connection with an additional 1923 tax based upon 1922 income.

Four. Acting as aforesaid, and through and by the Income Tax Division of his department, the respondent Commissioner did by tax bill dated December 1, 1923 make demand upon the complainant for payment of $1,605 being $1,500 assessed the said complainant as an additional income tax for the year 1922 plus interest of $105 at the rate of 6% per annum from October 1, 1922, including in said assessment the amount of $1,500 as a tax upon compensation for services and U. S. patent royalties as additional taxable business income received during said year 1921 and disallowing all claims for depreciation or depletion of said patent values.

Five. That complainant duly paid said assessed tax and interest, as demanded, under compulsion and protest and did duly file an abatement claim with said respondent Commissioner and did set forth in said abatement claim and did urge at a hearing thereon, the contentions in substance as hereinafter set forth in this complaint.

Six. That said abatement claim and contentions therein were rejected by said respondent Commissioner and regis-

tered mail notice thereof given complainant, said notice being received by complainant on February 19, 1924.

Seven. That complainant contends:

(a) the assessment and demand for said tax of $1,500 is illegal and excessive.

(b) the assessment and demand for said interest of $105 is illegal.

(c) the tax originally and previously paid is excessive and the excess or over-payment to be found on said verification should be deducted against any additional tax found due for the subsequent year 1923, and as grounds for said contentions alleges as follows:

(a) the patents granted complainant by the United States Government prior to year 1916 and the royalties therefrom received by complainant in year 1921 are not taxable under said Chapter 62 (as amended), and there was error to include said royalties as subject to tax; and

[fol. 4] (b) the ownership of said patents and receipt of royalties in year 1921 under the facts did not constitute income derived "from professions, employments, trade or business" as defined under said Chapter 62 (as amended) and there was error to include royalties as subject to tax; and

(c) if said royalties are taxable as such income so derived, said Chapter permits of a reasonable allowance in year 1921 for depreciation or depletion of the patent values and what is reasonable is a question of fact based upon the patent values subsequent to January 1, 1916 and there was error in computing the 1921 allowance to complainant solely on the cost value prior to January 1, 1916 and thus failing to grant any allowance; and

(d) under the so-called cash receipt basis employed by complainant in his return several items of royalties and compensation for services are overstated and there was error in not excluding same on verification; and

(e) the interest item of $105 was demanded pursuant to the provisions of Chapter 143 of the Acts of 1922, and said Chapter does not apply on verification of tax returns due and filed prior to its approval and effective dates.

Eight. That your complainant brings this action under Section 47 of Chapter 62 of the General Laws, as amended by Chapter 113, General Acts of 1921 and as further amended by Chapter 287, General Acts of 1923.

Wherefore the complainant prays judgment for the sum of $1,605 any part thereof, or such greater sum as may be legally refundable.

George I. Rockwood, by Smith, Gage & Dresser, His Attorneys.

Commonwealth of Massachusetts,
Worcester, ss:

Superior Court

February 28th, A. D. 1924.

On the Complaint aforesaid, It is Ordered, That the Petitioner notify the said Henry F. Long, Commissioner of Corporations and Taxation for the Commonwealth of Massachusetts, to appear at this Court, at Worcester, in said County, on Thursday, the twentieth day of March current, by serving him with an attested copy of said Complaint, and this Order, fourteen days at least before said twentieth day of March, that he may, then and there, show cause why the prayer of said Complaint should not be granted.

Attest:

Frank L. Dean, Clerk.

Filed February 28th, 1924, and notice ordered to issue, ret. March 20th, 1924, service to be made 14 days before [fol. 5] ret. day. (Walsh, J.)

Notice issued as ordered. Attest: Frank L. Dean, Clerk.

May 15, 1924.—Edwin G. Norman, Esq. apptd. Commissioner—report to be filed on or before Sept. 1, 1924.

IN SUPERIOR COURT OF WORCESTER COUNTY

ANSWER—Filed April 10, 1924

The defendant for answer to the complaint herein says as follows:

1. He admits the allegations of the complaint except as hereinafter stated.

2. He denies that the income tax return filed by the complainant fully disclosed the income received by the complainant during the calendar year 1921, as alleged in paragraph 2 of the complaint.

3. As to paragraph 3 the defendant says that the additional tax assessed by him was based on his finding from the verification of said return or otherwise that a portion of the complainant's income subject to taxation for the year 1921 had not been assessed.

4. The defendant denies that the complainant's contentions and grounds for contentions stated in paragraph 7 are true, and says that the additional tax assessed was in every respect legal and valid.

Henry F. Long, Commissioner of Corporations and Taxation, by Alexander Lincoln, Assistant Attorney General.

IN SUPERIOR COURT OF WORCESTER COUNTY

[Title omitted]

REPORT OF COMMISSIONER—Filed June 1, 1925

Pursuant to an order of Court referring the above entitled case to me as Commissioner to hear the parties and their evidence, I have heard the parties and their evidence [fol. 6] and report my findings with such facts and questions of law as have been requested by either party as follows:

1. The petitioner was a citizen of this Commonwealth and resident of the City of Worcester on January 1, 1921

and for many years prior thereto, and has so continued to the present time; maintaining also then and during said period of time at said Worcester his principal place of business.

2. On or before March 1, 1922 the petitioner duly filed an income tax return with the income tax division of the Department of Corporations and Taxation of this Commonwealth, purporting to set forth all of the income received by the petitioner during the calendar year 1921. Said tax return was made on an actual cash basis, pursuant to Chapter 62 of the General Laws and acts amendatory thereof and in addition thereto.

3. Upon the basis of said tax return the Commonwealth assessed and the petitioner seasonably paid an income tax for the year 1922.

4. During the year 1923 the Respondent Commissioner, by said Income Tax Division, verified the return submitted by the petitioner above mentioned and claimed to find that the income of the petitioner for the tax year 1922 or some portion of the same had not been assessed. The Commissioner thereupon made an additional assessment. At the same time the Commissioner made an additional assessment for 1923, upon the petitioner, based upon income received by the petitioner during the year 1922 under a claim that the petitioner's income for 1922 or some portion of the same had not been assessed. The validity of this assessment is questioned in another action similar to this action, in this Court. The verification and assessments for these two years were made under the provisions of section 37 of chapter 62 of General Laws as amended.

5. In accordance with the former assessments mentioned in the next preceding paragraph the Respondent Commissioner by a tax bill dated December 1, 1923 made demand upon the petitioner for payment of the sum of $1,605. Of this amount demanded, the sum of $1,500 was assessed as the additional income tax based upon the extra assessment upon income claimed to have been received by the petitioner during the year 1921 and omitted from his return for that period. The remainder, $105, was interest on said

assessment at the rate of 6% per annum from October 1, 1922. The petitioner duly paid said assessed tax and interest as determined under compulsion and protest, and duly filed an abatement claim with said Respondent Commissioner, and at a hearing upon said abatement claim urged the contentions in support of his claim as set forth in the complaint in this proceeding. The said abatement claim and contentions were rejected by the Respondent Commissioner and registered mail notice thereof was given the petitioner, said notice being received by the petitioner on February 19, 1924.

6. In the return of the petitioner of income received by him for the year 1921 he included an item on account of royalties of $50,000; two items of salaries received from the two corporations herein mentioned totalling $46,000; the sum of $55 as director's fee; and an item of $24,917.20 returned as "additional compensation 1920 credited from Worcester Company." The two items of salaries covered amounts received by the petitioner at regular intervals during 1921. The payments included on account of royalties consisted of the sum of $20,000 actually paid to the petitioner on June 21, 1921; and the sum of $30,000 actually [fol. 7] paid to the petitioner on October 1, 1921. The item of $24,917.20 was credited to the petitioner on the books of the Worcester Company in the month of January, 1921 as of December 31, 1920. These two payments totalling $50,000 were charged by the Assistant Treasurer of the company to the petitioner as described in paragraph 13, and applied in part payment of certain royalty credits as of December 31, 1919 to the extent of $29,823.52 and of the 1920 additional compensation credit to the extent of $20,176.48. It is conceded by the defendant that the sum of $20,176.48 was by error twice included in the return and that the gross income should be reduced by deducting this amount, this error being discovered upon the verification above mentioned. In the same return the petitioner claimed as a deduction from his gross income depreciation and depletion on patents amounting to the sum of $100,000.

7. Upon verification of the petitioner's tax return of income received by him for the year 1921 the Income Tax

Division of the Department of Taxation disallowed the depreciation of $100,000 claimed. The disallowance of the depreciation claimed is objected to by the petitioner. The disallowance of the depreciation thus claimed; and the addition of interest on the tax assessed are objected to by the petitioner and are the principal ground for the present action to recover payment of the assessment resulting from these changes.

8. As above stated the sum of $105 was added to the assessment, being interest on the extra assessment from October 1, 1922. It is not disputed that the foundation for this claim of interest rests upon the provisions of chapter 143 of the Acts of 1922, approved May 10, 1922.

9. Upon the date of the complaint and from 1906 previous the petitioner has been the President, Treasurer and principal stockholder of the Rockwood Sprinkler Company, a corporation located in said City of Worcester. From time to time prior to 1916 the petitioner has invented certain sprinkler systems protected by patents, for the manufacture and sale of which systems said corporation was organized. These patents have been put to the use of the corporation by consent of the petitioner. In return for this use the corporation has paid to the petitioner certain sums as royalties. The royalty payments have been made at irregular intervals whenever requested by the petitioner. The rate of payments has always been based upon the units produced under the patent rights, but the rate per unit has not been uniform, being fixed from time to time by the petitioner. The petitioner also received from this corporation a weekly salary of a fixed amount paid to him each week. The petitioner's returns in the form of royalties above mentioned were paid to him in large amounts, there being only two payments made to him in the year 1921 and no payment in the year 1922.

10. In 1917 and since, there has been in existence another corporation called the Rockwood Sprinkler Company of Illinois. This company was affiliated with the first mentioned corporation, its function being to purchase the manufactured products of the Rockwood Sprinkler Company first mentioned and sell them in the parts of the country remote

from its neighborhood. The petitioner has, from its inception, been the President and Treasurer of the Illinois Company also, but no direct use has been made by the Illinois Company of the petitioner's patents and no sums as royalties or otherwise have been received by, or credited to, [fol. 8] the petitioner, from the Illinois Company for the use of the petitioner's patents.

11. In the matter of crediting the petitioner's royalties the Rockwood Sprinkler Company adopted and consistently used the following method. As soon as convenient in the settlement of accounts after the end of each calendar year the amount of royalties due to the petitioner from the articles sold by the company under the petitioner's patents during the previous calendar year, was computed by the assistant treasurer who had charge of the company's books of account. These computations were then delivered to the company's accountant and then with his approval were placed to the credit of the petitioner upon the books of the company as of the year preceding. This process was done before the closing of the company's books of account for the previous year.

12. As stated above the payment of royalties to the petitioner was made to him when requested and in such amounts as were requested. The petitioner was willing for the company to have the use of the money due him as royalties, as it saved the company from the necessity of borrowing money. There was no evidence introduced as to whether or not the company was in sufficient funds to pay the petitioner the amounts credited to him upon the dates they were so credited; and it appeared that before the assessment complained of the income tax division had made no investigation as to the financial condition of the company. It was admitted, however, that the company was at all times solvent and its assets at all times sufficient to pay the amounts credited to the petitioner.

13. As to the application of payments made to the petitioner on account of royalties, whenever a payment on account was requested by the petitioner, it was the custom of the assistant treasurer to place such payments against the oldest unpaid credits of the petitioner. This method

was adopted by the assistant treasurer as a mode of convenience and was without official sanction from the Board of Directors or other managing officers of the company.

14. As above mentioned in paragraph 7 the Commissioner disallowed a claim for a deduction on the petitioner's return for income received in 1921 on account of the depreciation or depletion on patents. The depreciation was claimed on account of the patents above referred to which were procured on inventions of the petitioner and used by the Rockwood Sprinkler Company. It is the contention of the Commissioner that the item of depreciation if allowed be based upon the original cost of the patents which so far as appears was not in excess of the sum of $2,000. It is admitted by both parties that on January 1, 1916, the patents in the aggregate, taking into consideration the varying length of time remaining for each patent, had increased to a very large amount. The agreement of the parties with relation thereto is as follows:

"It is agreed that, if material, the value of the patents (referred to in the complaint) on January 1, 1916 was six hundred thousand ($600,000) dollars and thereafter on each succeeding year to and including the year 1921 the value was the said sum of six hundred thousand ($600,000) dollars less that multiple of 9.09% of six hundred thousand ($600,000) dollars which corresponds to the number of years intervening between each succeeding year and the said date, January 1, 1916."

[fol. 9] 15. The amounts assessed as above stated upon the petitioner by the respondent have been by virtue of authority claimed under chapter 62 of General Laws and acts in amendment and in addition thereto. By section 38 of this chapter it is provided "The Commissioner may from time to time, make such rules and regulations, not contrary to this chapter, as he deems necessary to carry out its provisions." The Commissioner has accordingly made rules and regulations certain of which, relative to the subject matter of this complaint, are set forth in the following paragraph.

16. The rules and regulations of the Commissioner are as follows:

"1009. Income is considered to be received for the purposes of this act when (1) it is actually paid in cash, by check or other negotiable instrument, of the equivalent of cash; (2) when it is credited by a bank or banking institution; (3) when it is credited upon the books of a broker, banker or agent of the taxpayer; (4) when it is credited upon an open or running account between the parties with other mutual charges; (5) when payment therefor is made in merchandise or other commodities; (6) when payment therefor is made by services rendered."

"6028. Income received in the form of royalties, or in the form of other deferred payments, shall be taxable to the recipient as business income."

"6077. Royalties received by an heir of the original patentee or copyrightee are not taxable as business income."

"7032. One-seventeenth of the actual cost of securing or purchasing patent rights may be claimed as an annual allowance for the depletion thereof."

17. At the time of the acts complained of it was an established practice of the Income Tax Division of the Department of Corporations and Taxation of this Commonwealth, to regard as received, income credited to the account of a taxpayer when it could be drawn against; and where nothing appeared to the contrary to regard assets available to pay the amounts credited, and the credit a constructive receipt. If the fact of the amount to be credited could not be determined until after the closing period the division regarded the payment as made when the entry of the credit was actually made. It was also the practice to include royalties received as business income; and in the allowance for depreciation on patents yielding royalties, to determine the depreciation as one seventeenth of the cost of the patents, whether the income was received by one who purchased the patents or paid the original expense of acquiring them.

18. It is believed that the question of whether or not royalties as above described constituted taxable income in this Commonwealth; and whether, under the circumstances above, the royalties credited to the petitioner, if taxable income, were properly considered income when actually cred-

ited to the petitioner; and further if the interest assessed upon the petitioner as above described, was properly assessed under the provisions of chapter 143 of the Acts of 1922; and further if the depreciation on patents claimed by the petitioner was properly disallowed by the Commissioner; and, further, if on the aforesaid verification, the proper abatements were made; are all, in connection with [fol. 10] the facts of the case, questions of law to be decided by the court. If, however, it should appear that the abatement as requested by the petitioner or any part, is granted, the sum abated shall be repaid to the complainant by the State Treasurer with interest at the rate of 6% per annum from December 14, 1923 to the date of repayment.

19. At the request of the respondent I am attaching hereto Exhibit B, a schedule of the business income of the petitioner for the year 1921, with changes by the Commissioner.

Respectfully submitted.

Edwin G. Norman.

In Superior Court of Worcester County

Stipulation re Settlement of Case

It is hereby stipulated in the above cause that if the defendant's exceptions are overruled the amount to be repaid to the complainant is $799.04, with interest at the rate of six per cent from December 14, 1923, and costs.

Gage, Hamilton, June & White, Attorneys for Complainant. Alexander Lincoln, Assistant Attorney General.

Filed Dec. 2, 1925.

(Findings and rulings in both cases at end of following case, No. 27820.)

[fol. 11] In Superior Court of Worcester County

No. 27820

George I. Rockwood

vs.

Henry F. Long, Commissioner of Corporations and Taxation

Bill of Exceptions and Order Allowing Same—Filed November 11, 1925

This is a complaint and appeal under G. L., c. 62, § 47, from the refusal of the defendant to abate an additional income tax for the year 1923 on income received during the year 1922. The complaint and defendant's answer thereto are hereby made a part of this bill of exceptions. The case was referred to a commissioner to hear the parties and report the facts. The Commissioner's report is hereby made a part of this bill of exceptions. The case was then heard by Mr. Justice McLaughlin on the commissioner's report and upon certain documents, copies of which are hereto attached marked Exhibits "A" and "C." Thereafter the court made findings and rulings as shown by a memorandum thereof, which is hereby made a part of this bill of exceptions.

At the hearing before the court the defendant duly presented the following requests for rulings:

"1. Income from royalties received for the use of patents issued by the United States to the taxpayer upon inventions made by him is taxable as business income under G. L., c. 62, § 5 (b), as amended.

2. Income from royalties received by the complainant from the Rockwood Sprinkler Company, upon the facts reported by the commissioner, was properly assessed to the complainant by the Commissioner of Corporations and Taxation under G. L., c. 62, § 37, as amended, as business income taxable under G. L., c. 62, § 5 (b), as amended.

3. Income credited to the taxpayer upon an open or running account subject to be drawn by him at any time is in-

come received by him under G. L., c. 62, § 5, as amended, although such income is not computed upon a basis other than actual cash receipts.

4. Income from royalties received by the complainant from the Rockwood Sprinkler Company was received by him, upon the facts reported by the commissioner, when it was actually credited to his account upon the books of the company.

5. An allowance for depreciation in the value of patents of the United States secured by the taxpayer upon inventions made by him, based upon the actual cost of securing such patents, may be a reasonable allowance under G. L., c. 62, § 6 (b), as amended, although the value at the beginning of the year is greater than the cost.

6. The allowance by the Commissioner of Corporations and Taxation for depreciation in the value of the patents re- [fol. 12] ferred to in the complaint, upon the facts reported by the commissioner, on the basis of the actual cost of securing such patents, was a reasonable allowance under G. L., c. 62, § 6 (b), as amended."

The defendant seasonably excepted to the rulings of the court and his failure to rule by filing in the clerk's office the following written statements:

"Exceptions to Rulings

The defendant within three days after the receipt of notice from the clerk of the rulings and decision of the court in the above-entitled case hereby takes the following exceptions thereto.

1. The defendant excepts to the ruling that under the circumstances reported by the Commissioner the royalties were not income from business and therefore were not assessable.

2. The defendant excepts to the ruling that under the circumstances reported by the Commissioner the royalties were not income received within the meaning of the income tax law.

3. The defendants excepts to the decision hereinabove referred to."

"Defendant's Exception to Failure to Rule

The defendant within three days after the receipt of notices from the clerk of the rulings and decision of the court in the above-entitled case hereby excepts to the failure of the court in his decision to give rulings numbered 1, 2, 3, 4, 5 and 6, requested by the defendant."

Wherefore, being aggrieved by the rulings and decision of the court as hereinabove stated, the defendant brings this his bill of exceptions and prays that the same may be allowed.

Henry F. Long, Commissioner of Corporations and Taxation, by Alexander Lincoln, Assistant Attorney General.

Exceptions allowed. John D. McLaughlin, J. S. C.

Filed Nov. 11, 1925.

(For Exhibits "A" and "C" see copies attached to this record.)

In Superior Court of Worcester County

Bill of Complaint and Order to Notify Defendant—Filed February 28, 1924

(Filed under Section 47, Chapter 62 of the General Laws [fol. 13] as amended by Chapter 113, General Acts of 1921 as further amended by Chapter 287, General Acts 1923.)

Respectfully George I. Rockwood brings and files this complaint against Henry F. Long, as he is duly constituted Commissioner of Corporations and Taxation of the Commonwealth of Massachusetts, and as grounds for said complaint, alleges as follows:

One. That he was, on and prior to January 1, 1921, and has been since that date, and still is a citizen of said Commonwealth and resident of Worcester, in the County of Worcester and said Commonwealth, maintaining also at said Worcester his principal place of business.

Two. That pursuant to the provisions of Chapter 62 of the General Laws, and acts amendatory thereof and in addition thereto, complainant on or before March 1, 1923 did duly file an income tax return with the Income Tax Division of respondens't department fully making known therein items of income received by him during the calendar year 1922, and subsequent thereto the respondent did assess and the complainant did pay an income tax for the year 1922 based upon said return.

Three. That during the year 1923 the respondent Commissioner acting under and pursuant to the provisions of Section 37 of said Chapter 62, and acts amendatory thereof and in addition thereto, did claim to find by verification of said return that the income of the complainant for the year subject to taxation under said Chapter 62 or some portion thereof had not been assessed, and did thereupon and thereafter assess the same, at the same time similarly acting under said section in connection with an additional 1922 tax based on 1921 income.

Four. Acting as aforesaid, and through and by the Income Tax Division of his department, the respondent Commissioner did by tax bill dated December 1, 1923 make demand upon the complainant for payment of $1,537.85 being $1,522.62 assessed the said complainant as an additional income tax for the year 1923 plus interest of $15.23 at the rate of 6% per annum from October 1, 1923 including in said assessment the amount of $1,522.62 as a tax upon United States patent royalties as additional taxable business income received during said year 1922 and disallowing all claims for depreciation or depletion of said patent values.

Five. That complainant duly paid said assessed tax and interest, as demanded, under compulsion and protest and did duly file an abatement claim with said respondent Commissioner, and did set forth in said abatement claim and did urge at a hearing thereon, the contentions in substance as hereinafter set forth in this complaint.

Six. That said abatement claim and contentions therein were rejected by said respondent Commissioner and regis-

tered mail notice thereof given complainant, said notice being received by complainant on February 19, 1924.

Seven. That complainant contends:

(a) the assessment and demand for said tax of $1,522.62 is illegal and excessive.

(b) the tax originally and previously paid is excessive and the excess or over-payment to be found on said verifica-
[fol. 14] tion should be deducted against any additional tax found due for the prior year 1922, and as grounds for said contentions alleges as follows:

(a) the patents granted complainant by the United States Government prior to year 1916 and the royalties therefrom received by complainant in year 1922 are not taxable under said Chapter 62 (as amended), and there was error to include said royalties as subject to tax; and

(b) the ownership of said patents and receipt of royalties in year 1922 under the facts did not constitute income derived "from professions, employments, trade or business" as defined under said Chapter 62 (as amended) and there was error to include royalties as subject to tax; and

(c) if said royalties are taxable as such income so derived, said Chapter permits of a reasonable allowance in year 1922 for depreciation or depletion of the patent values and what is reasonable is a question of fact based upon the patent values subsequent to January 1, 1916 and there was error in computing the 1922 allowance to complainant solely on the cost value prior to January 1, 1916 and thus failing to grant any allowance; and

(d) under the so-called cash receipt basis employed by complainant in his return several items of royalties and compensation for services are overstated and there was error in not excluding same on verification;

Eight. That your complainant brings this complaint under Section 47 of Chapter 62 of the General Laws as amended by Chapter 113, General Acts of 1921 and as further amended by Chapter 287, General Acts of 1923.

Wherefore the complainant prays judgment for the sum of $1,522.62, any part thereof, or such greater sum as may be legally refundable.

George I. Rockwood, by Smith, Gage & Dresser, His Attorneys.

COMMONWEALTH OF MASSACHUSETTS,
Worcester, ss:

SUPERIOR COURT

February 28, A. D. 1924.

On the complaint aforesaid, it is ordered, That the petitioner notify the said Henry F. Long, Commissioner of Corporations and Taxation for the Commonwealth of Massachusetts, to appear at this Court, at Worcester, in said County, on Thursday, the twentieth day of March current, by serving him with an attested copy of said Complaint, and this Order, fourteen days at least before said twentieth day of March, that he may, then and there, show cause why the prayer of said Complaint should not be granted.

Attest:

Frank L. Dean, Clerk.

Filed February 28th, 1924, and notice ordered to issue, [fol. 15] ret. March 20th, 1924, service to be made 14 days before ret. day. (Walsh, J.)

Notice issued as ordered. Attest: Frank L. Dean, Clerk.

May 15, 1924, Edwin G. Norman, Esq. appt'd. Commissioner—report to be filed on or before Sept. 1, 1924.

IN SUPERIOR COURT OF WORCESTER COUNTY

ANSWER—Filed April 10, 1924

The defendant for answer to the complaint herein says as follows:

1. He admits the allegations of the complaint except as hereinafter stated.

2. He denies that the income tax return filed by the complainant fully disclosed the income received by the complainant during the calendar year 1922, as alleged in paragraph 2 of the complaint.

3. As to paragraph 3 the defendant says that the additional tax assessed by him was based on his finding from the verification of said return or otherwise that a portion

of the complainant's income subject to taxation for the year 1922 had not been assessed.

4. The defendant denies that the complainant's contentions and grounds for contentions stated in paragraph 7 are true, and says that the additional tax assessed was in every respect legal and valid.

Henry F. Long, Commissioner of Corporations and Taxation, by Alexander Lincoln, Assistant Attorney General.

In Superior Court of Worcester County

No. 27820

[Title omitted]

Report of Commissioner—Filed June 1, 1925

Pursuant to an order of Court referring the above entitled case to me as Commissioner to hear the parties and their evidence, I have heard the parties and their evidence [fol. 16] and report my findings with such facts and questions of law as have been requested by either party as follows:

1. The petitioner was a citizen of this Commonwealth and resident of the City of Worcester on January 1, 1921 and for many years prior thereto, and so continued to the present time, maintaining also then and during said period of time at said Worcester his principal place of business.

2. On or before March 1, 1923 the petitioner duly filed an income tax return with the income tax division of the Department of Corporations and Taxation of this Commonwealth, purporting to set forth all of the income received by the petitioner during the calendar year 1922. Said tax return was made on an actual cash basis, pursuant to Chapter 62 to the General Laws and acts amendatory thereof and in addition thereto.

3. Upon the basis of said tax return the Commonwealth assessed and the petitioner seasonably paid an income tax for the year 1923.

4. During the year 1923 the Respondent Commissioner, by said Income Tax Division, verified the return submitted by the petitioner above mentioned and claimed to find that the income of the petitioner for the tax year 1923 or some portion of the same had not been assessed. The Commissioner thereupon made an additional assessment. At the same time the Commissioner made an additional assessment for 1922, upon the petitioner, based upon income received by the petitioner during the year 1921 under a claim that the petitioner's income for 1921 or some portion of the same had not been assessed. The validity of this assessment is questioned in another action similar to this action, in this Court. The verification and assessments for these two years were made under the provisions of section 37 of chapter 62 of General Laws as amended.

5. In accordance with the former assessments mentioned in the next preceding paragraph the Respondent Commissioner by a tax bill dated December 1, 1923 made demand upon the petitioner for payment of the sum of $1,537.85 Of this amount demanded, the sum of $1,522.22 was assessed as the additional income tax based upon the extra assessment upon income claimed to have been received by the petitioner during the year 1922 and omitted from his return for that period. The remainder, $15.23, was interest on said assessment at the rate of six per cent per annum from October 1, 1923. The petitioner duly paid said assessed tax and interest as determined under compulsion and protest, and duly filed an abatement claim with said Respondent Commissioner, and at a hearing upon said abatemen claim urged the contentions in support of his claim as set forth in the complaint in this proceeding. The said abatement claim and contentions were rejected by the Respondent Commissioner and registered mail notice thereof was given the petitioner, said notice being received by the petitioner on February 19, 1924.

6. In the return of the petitioner of income received by him for the year 1922 he did not include as income certain royalties, consisting of two items totalling $29,767.80, placed to his credit as hereinafter described by the Rockwood Sprinkler Company, a corporation with which he

was connected, in the month of January, 1922, as of the 31st day of December, 1921, and other royalties consisting of two items totalling $20,291.90, placed to his credit by said company on the 30th of June 1922. In this return the peti- [fol. 17] tioner's income only included his salary received from said Rockwood Sprinkler Company and another corporation herein described, amounting to $54,200; and his fees as director amounting to $120, specifically stating no receipts on account of royalties. In the same return the petitioner claimed as a deduction from his gross income depreciation or depletion on patents amounting to the sum of $100,000.

7. Upon verification of the petitioner's tax return of income received by him for the year 1922, the Income Tax Division of the Department of Taxation disallowed the depreciation of $100,000 claimed; and added to the income received the royalties placed to the credit of the petitioner by the Rockwood Sprinkler Company, above mentioned. The changes thus made by the Respondent Commissioner in the petitioner's tax return for the year 1922 are objected to by the petitioner and form the principal ground for the present action to recover payment of the assessment resulting from these changes.

8. As above stated the sum of $15.23 was added to the assessment, being interest on the extra assessment from October 1, 1923. It is not disputed that the foundation for this claim of interest rests upon the provisions of chapter 143 of the Acts of 1922, approved May 10, 1922.

9. Upon the date of the complaint and from 1906 previous the petitioner has been the President, Treasurer and principal stockholder of the Rockwood Sprinkler Company, a corporation located in said City of Worcester. From time to time prior to 1916 the petitioner has invented certain sprinkler systems protected by patents, for the manufacture and sale of which systems said corporation was organized. These patents have been put to the use of the corporation by consent of the petitioner. In return for this use the corporation has paid to the petitioner certain sums as royalties. The royalty payments have been made at irregular intervals whenever requested by the petitioner.

The rate of payments has always been based upon the units produced under the patent rights, but the rate per unit has not been uniform, being fixed from time to time by the petitioner. The petitioner also received from this corporation a weekly salary of a fixed amount paid to him each week. The petitioner's returns in the form of royalties above mentioned were paid to him in large amounts, there being only two payments made to him in the year 1921 and no payment in the year 1922.

10. In 1917 and since, there has been in existence another corporation called the Rockwood Sprinkler Company of Illinois. This company was affiliated with the first mentioned corporation, its function being to purchase the manufactured products of the Rockwood Sprinkler Company first mentioned and sell them in the parts of the country remote from its neighborhood. The petitioner has, from its inception, been the President and Treasurer of the Illinois Company also, but no direct use has been made by the Illinois Company of the petitioner's patents and no sums as royalties or otherwise have been received by, or credited to, the petitioner, from the Illinois Company for the use of the petitioner's patents.

11. In the matter of crediting the petitioner's royalties the Rockwood Sprinkler Company adopted and consistently used the following method. As soon as convenient in the settlement of accounts after the end of each calendar year the amount of royalties due to the petitioner from the articles sold by the company under the petitioner's patents [fol. 18] during the previous calendar year, was computed by the assistant treasurer who had charge of the company's books of account. These computations were then submitted to the company's accountant and then with his approval were placed to the credit of the petitioner upon the books of the company as of the year preceding. This process was done before the closing of the company's books of account for the previous year. In the verification of the return of income submitted by the petitioner for the year 1922 above mentioned, and in making the changes as described in paragraph 7 above, the additional items of royalties which were credited upon the books of the Rockwood

Sprinkler Company as of December 31, 1921 were actually made in the following January. For special reasons royalty credits were made by the company for the petitioner at other times, and the two items added by the Commissioner upon verification as credited on June 30, 1922, were made in July following. Royalties were placed to the credit of the petitioner amounting to $23,893.40 in the month of January 1923 as of December 31, 1922.

12. As stated above the payment of royalties to the petitioner was made to him when requested and in such amounts as were requested. The petitioner was willing for the company to have the use of the money due him as royalties, as it saved the company from the necessity of borrowing money. There was no evidence introduced as to whether or not the company was in sufficient funds to pay the petitioner the amounts credited to him upon the dates they were so credited; and it appeared that before the assessment complained of the income tax division had made no investigation as to the financial condition of the company. It was admitted, however, that the company was at all times solvent and its assets at all times sufficient to pay the amounts credited to the petitioner.

13. As to the application of payments made to the petitioner on account of royalties, whenever a payment on account was requested by the petitioner, it was the custom of the assistant treasurer to place such payments against the oldest unpaid credits of the petitioner. This method was adopted by the assistant treasurer as a mode of convenience and was without official sanction from the Board of Directors or other managing officers of the company. As above stated no part of the credited amounts by the Rockwood Sprinkler Company which were added by the Income Tax Division in the verification of the petitioner's tax return of the income for the year 1922 were paid to the petitioner during the year 1922.

14. As above mentioned in paragraph 7 the Commissioner disallowed a claim for a deduction on the petitioner's return for income received in 1922 on account of the depreciation or depletion on patents. The deprecia-

tion was claimed on account of the patents above referred to which were procured on inventions of the petitioner and used by the Rockwood Sprinkler Company. It is the contention of the Commissioner that the item of depreciation if allowed be based upon the original cost of the patents which so far as appears was not in excess of the sum of $2,000. It is admitted by both parties that on January 1, 1916, the patents in the aggregate, taking into consideration the varying length of time remaining for each patent, had increased to a very large amount. The agreement of the parties with relation thereto is as follows:

[fol. 19] "It is agreed that, if material, the value of the patents (referred to in the complaint) on January 1, 1916 was six hundred thousand ($600,000) dollars and thereafter on each succeeding year to and including the year 1922 the value was the said sum of six hundred thousand ($600,000) dollars less that multiple of 9.09% of six hundred thousand ($600,000) dollars which corresponds to the number of years intervening between each succeeding year and the said date, January 1, 1916."

15. The amounts assessed as above stated upon the petitioner by the respondent have been by virtue of authority claimed under chapter 62 of General Laws and acts in amendment and in addition thereto. By section 38 of this chapter it is provided "The Commissioner may from time to time, make such rules and regulations, not contrary to this chapter, as he deems necessary to carry out its provisions." The Commissioner has accordingly made rules and regulations certain of which, relative to the subject matter of this complaint, are set forth in the following paragraph.

16. The rules and regulations of the Commissioner are as follows:

"1009. Income is considered to be received for the purposes of this act when (1) it is actually paid in cash, by check or other negotiable instrument, or the equivalent of cash; (2) when it is credited by a bank or banking institution; (3) when it is credited upon the books of a broker, banker or agent of the taxpayer; (4) when it is credited upon an open or running account between the parties with

other mutual charges; (5) when payment therefor is made in merchandise or other commodities; (6) when payment therefor is made by services rendered "

"6028. Income received in the form of royalties, or in the form of other deferred payments, shall be taxable to the recipient as business income."

"6077. Royalties received by an heir of the original patentee or copyrightee are not taxable as business income."

"7032. One-seventeenth of the actual cost of securing or purchasing patent rights may be claimed as an annual allowance for the depletion thereof."

17. At the time of the acts complained of it was an established practice of the Income Tax Division of the Department of Corporations and Taxation of this Commonwealth, to regard as received, income credited to the account of a taxpayer when it could be drawn against; and where nothing appeared to the contrary to regard assets available to pay the amounts credited, and the credit a constructive receipt. If the fact of the amount to be credited could not be determined until after the closing period the division regarded the payment as made when the entry of the credit was actually made. It was also the practice to include royalties received as business income; and in the allowance for depreciation on patents yielding royalties, to determine the depreciation as one seventeenth of the cost of the patents, whether the income was received by one who purchased the patents or paid the original expense of acquiring them.

[fol. 20] 18. It is believed that the question of whether or not royalties as above described constituted taxable income in this Commonwealth; and whether, under the circumstances above, the royalties credited to the petitioner, if taxable income, were properly considered income when actually credited to the petitioner; and further if the interest assessed upon the petitioner as above described, was properly assessed under the provisions of chapter 143 of the Acts of 1922; and further if the depreciation on patents claimed by the petitioner was properly disallowed by the Commissioner; are all, in connection with the facts of the case, questions of law to be decided by the court. If, however, it should appear that the abatement as requested by

the petitioner or any part, is granted, the sum abated shall be repaid to the complainant by the State Treasurer with interest at the rate of 6% per annum from December 14, 1923 to the date of repayment.

19. At the request of the respondent I am attaching hereto Exhibit C, a schedule of the business income of the petitioner for the year 1922, with changes by the Commissioner.

Respectfully submitted.

Edwin G. Norman

In Superior Court of Worcester County.

Findings and Rulings.—Filed October 24, 1925.

These are two complaints filed under section 47, chapter 62 of the General Laws by way of appeal from the refusal of the respondent to abate an income tax assessed upon the complainant by the commissioner of corporations and taxation for income received in the year 1921, and to abate an income tax assessed upon the complainant for income received in the year 1922. The complaint numbered 27819 relates to the income for 1921, and the complaint numbered 27820 to the income for 1922, the tax for 1921, of which he complains, being assessed in 1922, and the tax for 1922 being assessed in 1923. Both cases were heard by me on the reports of a commissioner to whom they were referred by the court, and upon certain documents which were before the commissioner but were not annexed to his reports.

As to the complaint numbered 27819: The complainant's return for the year 1921, so far as material to the issues involved, was as follows:

Schedule of Business Income, George I. Rockwood

1922 tax for year 1921

Cash payments on a/c royalties	$50,000.00	
Salary Worcester Company	26,000.00	
" Chicago Company	20,000.00	
Director's fees	55.00	
Additional compensation 1920, Credit from Worcester Company	24,917.20	
Gross Income		$120,972.20

[fol. 21]

Less deductions, etc.:

Part State income tax	$822.63	
" Federal income tax	9,280.50	
Depreciation or depletion on patents	100,000.00	
Statutory exemptions	2,750.00	
		$112,853.13
		$8,119.07

It appears at the outset from paragraph 6 of the commissioner's report that in this return the complainant erroneously charged himself twice with the receipt of the sum of $20,176.48 Upon the facts reported by the commissioner in this connection, it would seem that the proper correction of this error would require the item "cash payments on account royalties $50,000" to be amended by reducing it to $29,823.52, thus changing the item of total gross income from $120,972.20 to $100,795.72.

Under the heading "deductions," the complainant included an item "depreciation or depletion on patents $100,000," meaning the patents which produced the royalties mentioned in the previous item. Upon verification of the complainant's return, the respondent disallowed this item, assessed the tax at 1½% on $108,119.07 and to the tax thus assessed added interest at six per cent from October 1, 1922, which the complainant paid on December 14, 1923. the whole amount being $1,605.

The first and principal question which arises is whether the complainant was taxable on his income for royalties,

fixed in his return at $50,000, but which when corrected, as I have said, should have been stated as $29,823.52.

It seems to be generally held (see Cooley on Taxation, vol. 2, § 618, and cases collected in note, and In re Sheffield, 64 Fed. 833) that it is not competent for the states to tax patent rights conferred by the United States. It would seem doubtful, therefore, whether they can tax the income which a patentee or his assignee derives directly from leasing to others the right to manufacture under his patent. See Gillespie vs. Oklahoma, 257 U. S. 501, 506. Whatever the correct view may be in this respect, I find and rule on the findings of the commissioner that in this case the income from the royalties was not income from business, and not being income from any of the kinds of "intangible personal property" specified in the income tax law, was not taxable. The complainant's return, therefore, should have omitted the item of income from royalties, and consequently should have omitted, also, the item of depreciation or depletion on the patents from which the royalties were obtained (see Gen. Laws, c. 62, § 6, cl. b), the provision in said section 6 of chapter 62 for a reasonable allowance for depreciation and obsolescene of property, applying, as I construe it, only to property from which taxable income is derived, or to assets owned and used in a business from which such income is derived. The total of gross income, therefore, should have been stated at $70,972.20; and the total of deductions at $12,853.13, the complainant being taxable at 1½% on the difference, viz., on $58,119.07, one and one half per cent of which is $871.68. To this amount interest at six per cent should be added under St. 1922, c. 143, from October 1, 1922, this statute, as I rule against the contention of the complainant, being applicable to the present case.

[fol. 22] As to the complaint numbered 27820: This relates, as I have said, to the refusal of the commissioner of corporations and taxation to abate the income tax assessed upon the complainant for his income in the year 1922. His return for that year, so far as material, was as follows:

Schedule of Business Income, George I. Rockwood

1923 Tax for Year 1922

Cash payments on account royalties	None	
Salary a/c paid by Worcester Co.	$24,200.00	
" " " " Chicago Co.	30,000.00	
Director's fees	120.00	
Gross Income		$54,320.00
Less deductions, etc.:		
Part State income tax	$121.79	
Depreciation or depletion on patents	100,000.00	
Statutory exemptions, etc.	2,750.00	
		102,871.79
Taxpayer's net income taxable at 1½% (loss)		48,551.79

The complainant stated, as it appears, that he received no cash payments on account of royalties, reported the receipt of other income, salaries and director's fees, and among other items, included an item of deduction "for depreciation or depletion on patents" in the sum of $100,000. The commissioner of corporations and taxation disallowed this item of depreciation and assessed him on royalties amounting to $50,059.60, describing them as credited to the complainant on the books of the Rockwood Sprinkler Company, some in 1921 and some in 1922, and all as having become "available" to the complainant in 1922; treated them as income received, and fixed his net taxable income for the year 1922 at $101,507.81, taxing him at the rate of 1½% of this amount with interest from October 1, 1922. These royalties were credited to the complainant on the books of the Rockwood Sprinkler Company for the year 1922, but were not actually received by him. The complainant paid this tax on December 14, 1923, the whole amount being $1,537.85.

I find and rule, first, as I ruled in the case of the complaint numbered 27819, apart from the question whether these royalties were received within the meaning of the income tax law, that, under the circumstances reported by the commissioner, they were not income from business, nor

income from any of the kinds of intangible personal property specified in the income tax law, and therefore not assessable. Secondly, apart from the question whether the royalties were income from business or from property, I rule, under the circumstances reported by the commissioner, that they were not income received within the meaning of the income tax law.

If I am correct in these views, the claimed depreciation and depletion in the value of the patents from which the royalties were derived, should not be allowed for the reasons given in connection with the 1921 tax; the net taxable income of the complainant should be stated at $51,448.21, [fol. 23] and his tax, reckoned at one and a half per cent thereof, fixed at $771.72, with interest at six per cent from October 1, 1922, to the date when he paid it.

On December 14, 1923, on the assessment of the commissioner of corporations and taxation, the complainant paid the tax for the year 1921 in the sum of $1,605. Deducting therefrom the sum of $871.68, the correct amount for which I find he was assessable, and interest thereon at six per cent from October 1, 1922 to December 14, 1923, the date when he paid, I find on the complaint numbered 27819 that the complainant is entitled to an abatement of $671, and to be repaid this amount by the state treasurer, with interest at the rate of six per cent from December 14, 1923, and costs.

On the assessment of the commissioner, the complainant paid the tax for income received in the year 1922 in the sum of $1,537.85. Deducting from this the sum of $771.72, for which I find he was assessable, and interest thereon from October 1, 1923 to December 14, 1923, when he paid, I find on the complaint numbered 27820 that the complainant is entitled to an abatement of $756.95, and to be repaid this amount by the state treasurer, with interest at the rate of six per cent from December 14, 1923, and costs.

John D. McLaughlin, J. S. C.

(Exhibits not attached except to copies for Full Court.)

[fol 24] IN SUPERIOR COURT OF WORCESTER COUNTY

EXHIBIT B

E. G. N.

Schedule of Business Income, George I. Rockwood

1922 Tax for year 1921

Returned by taxpayer:

Cash payments on a/c royalties	$50,000.00	
Salary Worcester Company	26,000.00	
" Chicago Company	20,000.00	
Director's fees	55.00	
Additional compensation 1920, Credit from Worcester Company	24,917.20	
Gross Income		$120,972.20
Less deductions, etc.:		
Part State income tax	$822.63	
" Federal income tax	9,280.50	
Depreciation or depletion on patents	100,000.00	
Statutory exemptions	2,750.00	
		112,853.13
Taxpayer's Net Income taxable at 1½%		$8,119.07
To which Respondent Commissioner added:		
Disallowance of depreciation or depletion of patents		100,000.00
Respondent Commissioner's adjusted net taxable income		$108,119.07

(Here follows analysis of account of George I. Rockwood, marked side folio page 25.)

[fols. 26 & 26½] EXHIBIT C

E. G. N.

Schedule of Business Income, George I. Rockwood

1923 Tax for Year 1922

Returned by taxpayer:		
Cash payments on account royalties	None	
Salary a/c paid by Worcester Co.	$24,200 00	
Salary a/c paid by Chicago Co.	30,000 00	
Director's fees	120 00	
Gross Income		$54,320 00
Less deductions, etc.:		
Part State income tax	$121 79	
Depreciation or depletion on patents	100,000 00	
Statutory exempts, etc.	2,750 00	
		102,871 79
Taxpayer's net income taxable at 1½% (loss)		$48,551 79
To which Respondent Commissioner added:		
Disallowance of depreciation and depletion on patents	$100,000 00	
Sprinkler head royalties credited 12/31/21 and "available" 1922	19,227 70	
Dry pipe valve royalties credited 12/31/21 and "available" 1922	10,540 00	
Sprinkler head royalties credited 6/30/22 and "available" 1922	11,561 90	
Dry pipe valve royalties credited 6/30/22 and "available" 1922	8,730 00	
		$150,059 60
Respondent Commissioner's adjusted net taxable income		$101,507 81

A copy. Attest: Frank L. Dean, Clerk.

[fols. 27 & 27½] In Supreme Judicial Court of Massachusetts

In the Case of

George I. Rockwood

vs.

Henry F. Long (Commissioner of Corporations & Taxation),

Pending in the Superior Court for the County of Worcester

Order Overruling Exceptions—November 27, 1926

Ordered, that the clerk of said court in said county make the following entry under said case in the docket of said court, viz: Exceptions overruled.

By the Court.

Walter F. Frederick, Clerk.

Brief Statement of the Grounds and Reason of the Decision

See opinion on file.

Filed Nov. 30, 1926. Attest: Frank L. Dean, Clerk.

[fols. 28 & 28½] In Supreme Judicial Court of Massachusetts

In the Case of

George I. Rockwood

vs.

Henry F. Long (Commissioner of Corporations & Taxation),

Pending in the Superior Court for the County of Worcester

Order Overruling Exceptions—November 27, 1926

Ordered, that the clerk of said court in said county make the following entry under said case in the docket of said court, viz: Exceptions overruled.

By the Court.

Walter F. Frederick, Clerk.

Brief Statement of the Grounds and Reason of the Decision

See opinion on file.

Filed Nov. 30, 1926. Attest: Frank L. Dean, Clerk.

[fol. 29] In Supreme Judicial Court of Massachusetts

Opinion

Carroll, J.:

In these two complaints the decisive question is the right of the Commonwealth to tax the income received from royalties for the use of patents issued by the United States. The complaints are against the commissioner of corporations and taxation for the abatement of income taxes assessed for income received in the years 1921 and 1922. The judge of the Superior Court found for the complainant; the respondent excepted.

The complainant, a resident of Worcester for several years, was the president and principal stockholder of the

Rockwood Sprinkler Company, a corporation located at Worcester, and of the Rockwood Sprinkler Company of Illinois. He invented, from time to time prior to the year 1916, certain sprinkler systems protected by patents. From these he received royalties, which were paid to him by the Worcester company for the use of the patents.

A patent right itself is not taxable by a State. Letters patent of the United States give to the patentee a right of monopoly in the invention, with this right the State cannot interfere. It is conceded by the respondent that the rights secured by the patents could not be taxed by the State without the consent of Congress. Webber v. Virginia, 103 U. S. 344, 347. M'Culloc v. State of Maryland, 4 Wheat. 316, 432. Opinion of the Justices, 193 Mass. 605, 608, 609. People v. Assessors, 156 N. Y. 417, 418.

As a State cannot tax the patent, it cannot tax the royalties received from its use. What the State cannot do directly, it cannot accomplish in an indirect way. The true [fol. 30] nature of the Tax must be considered. A tax on rents received from land is the same in substance as a tax on the land itself. Rights under patents could be impaired or destroyed if taxed by the State, and if royalties from patents can be taxed, the right itself might thereby be destroyed. The Legislature, in giving a tax a particular name, cannot "take away our duty to consider its real nature and effect." See Choctaw, Oklahoma & Gulf Railroad v. Harrison, 235 U. S. 292, 298; Pollock v. Farmers' Loan & Trust Co., 157 U. S. 429, 581.

In Gillespie v. State of Oklahoma, 257 U. S. 501, 506, where it was held that, a tax upon a lease of Indian lands being invalid, a tax upon the income received from the lease is invalid, it was said: "The same considerations that invalidate a tax upon the leases invalidate a tax upon the profits of the leases * * * a tax upon such profits is a direct hamper upon the effort of the United States to make the best terms that it can for its wards." "A tax upon the leases is a tax upon the power to make them, and could be used to destroy the power to make them." Indian Territory Illuminating Oil Co. v. State of Oklahoma, 240 U. S. 522, 530. "A tax upon the income of property is in reality a tax upon the property itself." Opinion of the Justices, 220 Mass. 613, 624.

A patented article, when manufactured, may be taxed by the State. A tax on such property, however, is not a tax on the privilege granted to the patentee by the Federal government. The right to exclude others from making or selling the patented article is not interfered with by a tax on the patented article when made. Webber v. Virginia, supra. It has been decided that a Federal estate tax may be assessed on an estate in which were included State and municipal bonds. "The transfer upon death is taxable, whatsoever the character of the property transferred and to whomsoever the transfer is made." Greiner v. Lewellyn, 258 U. S. 384, 387. But the tax levied on the royalties in the cases at bar was in effect a tax on the patent itself. It was a property tax, Hart v. Tax Commissioner, 240 Mass. 37, 39, and was beyond the power of the State.

United States Glue Co. v. Town of Oak Creek, 247 U. S. 321, 326, is not in conflict. In that case it was said, "A [fol. 31] State may not directly burden interstate commerce, either by taxation or otherwise. But a tax that only indirectly affects the profits or returns from such commerce, is not within the rule." This case was distinguished in Gillespie v. Oklahoma, supra. "The criterion of interference by the States with interstate commerce is one of degree. It is well understood that a certain amount of reaction upon and interference with such commerce cannot be avoided if the States are to exist and make laws. * * * The rule as to instrumentalities of the United States on the other hand is absolute in form and at least stricter in substance." Gillespie v. Oklahoma, supra, at 505. We find nothing in Fidelity & Deposit Co. of Maryland v. Commonwealth of Pennsylvania, 240 U. S. 319, and similar cases cited on the respondent's brief, inconsistent with what is here decided. As the income from royalties on the patents issued by the United States were not taxable, the exceptions of the respondent are overruled. It becomes unnecessary, therefore, to consider the other questions argued by the complainant and respondent.

In each case the entry must be: Exceptions overruled.

COMMONWEALTH OF MASSACHUSETTS:

Boston, February 17, 1927.

I certify the foregoing to be a true copy of the opinion of the Supreme Judicial Court in the two cases of George I. Rockwood vs. Commissioner of Corporations and Taxation, decided on the twenty-seventh day of November, 1926.

Ethelbert V. Grabill, Reporter of Decisions.

[fol. 32] IN SUPERIOR COURT OF WORCESTER COUNTY

#27819

GEORGE I. ROCKWOOD

v.

HENRY F. LONG, Commissioner Corporations & Taxation

JUDGMENT—Filed December 27, 1926

Abatement for $799.04 is granted, that amount having been paid on December 14, 1923, together with interest thereon at the rate of 6% per annum from the date of payment, and costs of suit taxed at $93. Shall be paid to the complainant by the State Treasurer in accordance with General Laws, Chapter 62, Section 47, as amended by Chapter 287 Acts of 1926.

By the Court.

Frank L. Dean, Clerk.

December 24, 1926.

The above order may be entered. John D. McLaughlin, Justice Superior Court.

[File endorsement omitted.]

[fol. 33] In Superior Court of Worcester County

#27820

George I. Rockwood

v.

Henry F. Long, Commissioner Corporations & Taxation

Judgment—Filed December 27, 1926

Abatement for $756.95 is granted, that amount having been paid on December 14, 1923, together with interest thereon at the rate of 6% per annum from the date of payment, and costs of suit taxed at $43.00 shall be paid to the complainant by the State Treasurer in accordance with General Laws, Chapter 62, Section 47, as amended by Chapter 287 Acts of 1926.

By the Court.

Frank L. Dean, Clerk.

December 24, 1926.

The above order may be entered. John D. McLaughlin, Justice Superior Court.

[File endorsement omitted.]

[fol. 34] In Superior Court of Worcester County

No. 27819, No. 27820

[Title omitted]

Motion for Stay of Execution and Other Processes—Filed February 7, 1927

Now comes the defendant in the above-entitled actions and moves that the issuance by this court of any execution or other process subsequent to final judgment after rescript in said causes be stayed until said causes shall have been passed upon by the Supreme Court of the United

In Both Cases

	Credits	1920
Credit Balance Dec. 31, 1919:		
Royalties of 1918	$100,000.00	.....
Royalties of 1919 D. P. V.	21,360.00	$16,883.68
Royalties of 1919 Sprinkler	25,347.20	.....
Add: Compensation 1919	21,116.32	21,116.32
Item error adjusted in 1920	7.49	.....
Total Credit Balance Dec. 31, 1919	$167,816.03	.....
1920 Credits:		
*Salary Paid weekly	$26,500.00	26,500.00
Add: Compensation Credit Dec. 31, 1920	24,917.20	.....
Royalties Sprinkler Co. Dec. 31, 1920-Cr.	28,264.90	.....
Royalties D. P. V. Credit Dec. 31, 1920	21,630.00	.....
Adjustment Error of 1919	7.49	.....
	$101,319.59	.....
1921 Credits:		
*Salary Paid weekly	$26,000.00	.....
Royalties Sprinkler Co. Cr. Dec. 31, 1921	19,227.70	.....
Royalties D. P. V. Cr. Dec. 31, 1921	10,540.00	.....
	$55,767.70	.....
1922 Credits:		
*Salary Paid weekly	$24,200.00	.....
Royalties Sprinkler Co. Cr. June 30, 1922	11,561.90	.....
Royalties D. P. V. Cr. June 30, 1922	8,730.00	.....
Royalties Sprinkler Co. Cr. Dec. 31, 1922	9,663.40	.....
Royalties D. P. V. Cr. Dec. 31, 1922	14,230.00	.....
Item Error adjusted in 1923	8.50	.....
	$68,375.80	.....
1923 Credits:		
*Salary Paid weekly	$15,600.00	.....
Royalties Sprinkler Co. Cr. Dec. 31, 1923	37,618.40	.....
Royalties D. P. V. Cr. Dec. 31, 1923	31,930.00	.....
Adjustment Error 1922	8.50	.....
	$85,156.90	.....
Yearly Totals of Payments	.....	$64,500.00

*Note.—Salary paid weekly was neither credited nor charged by the company to

Analysis of Account of George I. Rockwood on Books of Roc

In Both Cases, 27819 and 27820

	Credits	Application of pa		
		1920	1921	1922
c. 31, 1919:				
918	$100,000.00	.....	.....	.....
919 D. P. V.	21,360.00	$16,883.68	$4,476.32	.....
919 Sprinkler	25,347.20	.....	25,347.20	.....
sation 1919	21,116.32	21,116.32	.....	.....
usted in 1920	7.49	.....	.....	.....
redit Balance Dec. 31, 1919	$167,816.03	.....	.....	.....
weekly	$26,500.00	26,500.00	.....	.....
sation Credit Dec. 31, 1920	24,917.20	.....	20,176.48	.....
nkler Co. Dec. 31, 1920-Cr.	28,264.90	.....	.....	.....
V. Credit Dec. 31, 1920	21,630.00	.....	.....	.....
rror of 1919	7.49	.....	.....	.....
	$101,319.59	.....	.....	.....
weekly	$26,000.00	.....	26,000.00	.....
nkler Co. Cr. Dec. 31, 1921	19,227.70	.....	.....	.....
V. Cr. Dec. 31, 1921	10,540.00	.....	.....	.....
	$55,767.70	.....	.....	.....
weekly	$24,200.00	.....	.....	$24,200.0
kler Co. Cr. June 30, 1922	11,561.90	.....	.....	.....
V. Cr. June 30, 1922	8,730.00	.....	.....	.....
nkler Co. Cr. Dec. 31, 1922	9,663.40	.....	.....	.....
V. Cr. Dec. 31, 1922	14,230.00	.....	.....	.....
usted in 1923	8.50	.....	.....	.....
	$68,375.80	.....	.....	.....
eekly	$15,600.00	.....	.....	.....
kler Co. Cr. Dec. 31, 1923	37,618.40	.....	.....	.....
V. Cr. Dec. 31, 1923	31,930.00	.....	.....	.....
ror 1922	8.50	.....	.....	.....
	$85,156.90	.....	.....	.....
otals of Payments	.....	$64,500.00	$76,000.00	$24,200.0

paid weekly was neither credited nor charged by the company to George I. Rockwood

Rockwood Sprinkler Co.

of payments 22	1923	1924	Actual dates and amounts of payments	
....	.....	.....		
....	.....	.....		
....	.....	.....		
....	.....	.....		
....	.....	.....		
....	.....	.....		
			1920.	
....	.....	.....	April 4	$3,000.00
....	$4,740.72	.....	May 27	10,000.00
....	28,264.90	.....	June 14	15,000.00
....	21,630.00	.....	Oct. 4	10,000.00
....	.....	.....	Salary Paid, $500 every week	26,500.00
....	.....	.....	....	$64,500.00
			1921.	
....	15,364.38	$3,863.32	June 21	$20,000.00
....	.....	10,540.00	Oct. 1	30,000.00
....	.....	.....	Salary Paid, $500 every week	26,000.00
				$76,000.00
00.00	.....	.....		
....	.....	.....	1922.	
....	.....	596.68	Salary paid every week:	
....	.....	.....	$500 part year }	$24,200.00
....	.....	.....	$300 " " }	
....	.....	.....	No other payments.	
....	.....	.....		$24,200.00
			1923.	
....	15,600.00	.....	May 25	$10,000.00
....	.....	.....	Oct. 11	50,000.00
....	.....	.....	Dec. 17	5,000.00
....	.....	.....	Dec. 31	5,000.00
....	.....	.....	Salary paid, $300 every week	15,600.00
00.00	$85,600.00	$15,000.00		$85,600.00

ood Account, but charged directly to Expense from Cash.

States, to which court the defendant is in process of taking said causes by petition for writs of certiorari.

By His Attorney, F. Delano Putnam, Assistant Attorney General.

The foregoing motion is assented to.

Gage, Hamilton, June & White, Merrill S. June, Attorneys for Plaintiff.

Feb. 7, 1927.
Filed. Attest: Frank L. Dean, Clerk.

Allowed: Philip J. O'Connell, J. S. C.

[fol. 35] In Superior Court of Worcester County

No. 27819

[Title omitted]

Docket Entries

1923 D

Counsel for plaintiff: Smith, Gage & Dresser; Gage, Hamilton, June & White.
Counsel for defendant: Attorney General.

Feb. 28, 1924.	1. Complaint filed—notice ordered to issue ret. Mar. 20, 1924, service to be made 14 days before ret. day—notice issued as ordered.
Mar. 10, 1924.	2. Return of service.
Mar. 11, 1924.	3. Appearance for deft.
Apr. 10, 1924.	4. Ans.
May 15, 1924.	Edwin G. Norman, Esq. appt'd Commissioner—report to be filed on or before Sept. 1, 1924. Rule issued.
Oct. 28, 1924.	5. Agreement of certain facts.
Nov. 14, 1924.	6. Time for completion of hearings before Commissioner & filing of report extended to & incl. Feb. 9, 1925.

Feb. 9, 1925.	7. Time for completion of hearings before Commissioner & filing report extended to & incl. June 1, 1925.
June 1, 1925.	8. Commissioner's report.
Oct. 24, 1924.	9. Court finds that the complainant is entitled to an abatement of $671 and to be repaid this amount by the State treasurer, with interest at the rate of six per cent from Dec. 14, 1923 and costs. (McLaughlin, J.)
	10. Findings and rulings.
Oct. 24, 1925.	11. Deft.'s exceptions to rulings.
Oct. 30, 1925.	12. Deft.'s exception to failure to rule.
Nov. 11, 1925.	13. Deft.'s bill of exceptions.
Dec. 2, 1925.	" " " " all'd.
	14. Stipulation.
Nov. 30, 1926.	15. Rescript received, viz: "Exceptions overruled."
Dec. 27, 1926.	16. Final order.
Feb. 7, 1927.	Judgment.
Feb. 7, 1927.	17. Deft.'s mo. for stay of execution & other processes filed & all'd. (O'Connell, J.)

[fol. 36] In Superior Court of Worcester County

No. 27820

[Title omitted]

Docket Entries

1923 D

Counsel for plaintiff: Smith, Gage & Dresser; Gage, Hamilton, June & White.

Counsel for Defendant: Attorney General.

Feb. 28, 1924.	1. Complaint filed—notice ordered to issue ret. Mar. 20, 1924, service to be made 14 days before ret. day: notice issued as ordered.

Mar. 10, 1924.	2. Return of service.
Mar. 11, 1924.	3. Appearance for deft.
Apr. 10. 1924.	4. Ans.
May 15, 1924.	Edwin G. Norman, Esq. appt'd Commissioner—report to be filed on or before Sept. 1, 1924. Rule issued.
Oct. 28, 1924.	5. Agreement of certain facts.
Nov. 14, 1924.	6. Time for completion of hearings before Commissioner & filing of report extended to & incl. Feb. 9, 1925.
Feb. 9, 1925.	7. Time for completion of hearings before Commissioner & filing of report extended to & incl. June 1, 1925.
June 1, 1925.	8. Commissioner's report.
Oct. 24, 1925.	9. Court finds that the complainant is entitled to an abatement of $756.95 and to be repaid this amount by the State treasurer, with interest at the rate of six per cent from December 14, 1923 and costs (McLaughlin, J.) See memo. in #27819.
Oct. 27, 1925.	10. Deft.'s exceptions to rulings.
Oct. 30, 1925.	11. Deft.'s exception to failure to rule.
Nov. 11, 1925.	12. Deft.'s bill of exceptions.
Dec. 2, 1925.	" " " " all'd.
Nov. 30, 1926.	13. Rescript received, viz: "Exceptions overruled."
Dec. 27, 1926.	14. Final order.
Feb. 7, 1927.	Judgment.
Feb. 7, 1927.	15. Deft.'s mo. for stay of execution & other processes filed & allowed (O'Donnell, J.)

[fol. 37] Clerk's certificate to foregoing transcript omitted in printing.

[fol. 38] Judge's certificate to clerk omitted in printing.

SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1927

No. 201

ORDER ALLOWING CERTIORARI—Filed April 25, 1927

The petition herein for a writ of certiorari to the Superior Court, County of Worcester, of the State of Massachusetts, is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1927

No. 202

ORDER ALLOWING CERTIORARI—Filed April 25, 1927

The petition herein for a writ of certiorari to the Superior Court, County of Worcester, of the State of Massachusetts, is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

MAR 24 1917
JAMES D. MAHONEY
CLERK

SUPREME COURT OF THE UNITED STATES

[redacted] 201

HENRY F. LONG, Commissioner of Conservation and Director of the Conservation of Game, Oregon, Petitioner,

vs.

GEORGE F. ROCKWOOD, Respondent.

[redacted] 202

HENRY F. LONG, Commissioner of Conservation and Director of the Conservation of Game, Oregon, Petitioner,

vs.

GEORGE F. ROCKWOOD, Respondent.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1926.

No. 993.

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION OF THE COMMONWEALTH OF MASSACHUSETTS, PETITIONER,

v.

GEORGE I. ROCKWOOD, RESPONDENT.

OCTOBER TERM, 1926.

No. 994.

HENRY F. LONG, COMMISSIONER OF CORPORATIONS AND TAXATION OF THE COMMONWEALTH OF MASSACHUSETTS, PETITIONER,

v.

GEORGE I. ROCKWOOD, RESPONDENT.

Petition for Writs of Certiorari to the Superior Court of the Commonwealth of Massachusetts for the County of Worcester.

To the Honorable the Supreme Court of the United States:

Your petitioner, Henry F. Long, Commissioner of Corporations and Taxation of the Commonwealth of Massachusetts, respectfully represents as follows:

Short Statement of Matter Involved.

The respondent, George I. Rockwood, of Worcester, in said Commonwealth, is the complainant in two complaints filed on February 28, 1924 (R. 3, 17), in the Superior Court of said Commonwealth against your petitioner, under Section 47 of chapter 62 of the General Laws of Massachusetts, appealing from the refusal of your petitioner to abate additional income taxes for the years 1922 and 1923, assessed by your petitioner under the provisions of said chapter on income received by the complainant during the years 1921 and 1922 respectively (R. 3-6, 17-19). Included in the income so assessed was income from royalties received by the respondent from the Rockwood Sprinkler Company (R. 9, 22-23), a corporation located in said Worcester, of which the respondent for many years has been the president, treasurer, and principal stockholder. From time to time prior to 1916 the respondent invented certain sprinkler systems protected by patents, for the manufacture and sale of which systems the corporation was organized (R. 10, 23). These inventions have been used by the corporation with the consent of the respondent, and in return for this use the royalties referred to were paid.

In his complaints the complainant (respondent herein) alleged as one of the grounds for his contentions that "the patents granted and the royalties therefrom received by complainant * * * are not taxable under said chapter 62 (as amended), and there was error to include said royalties as subject to tax" (R. 5, 19).

Your petitioner's answers to said complaints denied that the complainant's contentions and grounds for contentions were true and alleged that the additional taxes assessed were in every respect legal and valid (R. 7, 20).

Pursuant to the requirements of the statutes of Massachusetts, the cases were referred to a commissioner to hear the parties and report the evidence. Upon the filing of the commissioner's reports the cases were heard in the superior court and findings and rulings were made to which your petitioner duly excepted (R. 28-32).

On your petitioner's bills of exceptions the cases were taken before the full court of the Supreme Judicial Court of the Commonwealth of Massachusetts and said exceptions were overruled (R. 36). Said decision is reported in Massachusetts Advance Sheets, 1926, page 2135. The ground of the decision, as shown by the opinion of said court, was that the tax levied on the royalties received by the respondent was in effect a tax on the patents for which the royalties were paid, which was beyond the power of the State (R. 37).

Following the rescript from the full court final orders were entered in the superior court on December 27, 1926, granting an abatement (R. 40).

The superior court is the highest court of the State in which a decision of the suit could be had.

Reasons Relied on for Allowance of Writs.

Upon this statement of the facts and the record in the cases your petitioner submits that the judgments

of the Superior Court of the Commonwealth of Massachusetts are erroneous, and that a review on writs of certiorari should be granted for these reasons:

(1) Because the cause is one wherein a final judgment has been rendered by the highest court of Massachusetts in which a decision could be had where a title, right, privilege, or immunity is specially set up or claimed by the complainant under the Constitution or statutes of or authority exercised under the United States.

(2) Because the full court of the supreme judicial court erred in holding that a tax on income received from royalties paid under a license or other contract for the use of rights secured by patents is beyond the power of the State to impose.

(3) Because the State court has decided a Federal question of substance not heretofore determined by this Court.

(4) Because the decision of the State court is not in accord with applicable decisions of this Court.

(5) Because the question whether income from royalties paid for the use of rights derived from or protected by patents, copyrights, and other similar privileges granted by the United States may be taxed by a State is a question of public interest and importance on which there is no direct authority known to your petitioner aside from the decision in question.

(6) Because, as your petitioner is advised, it has been the practice to tax such income in States where taxes on income are levied.

Wherefore your petitioner respectfully prays that writs of certiorari be issued to require that said causes be certified to this Honorable Court for review and determination, pursuant to the provisions of Section 237 of the Judicial Code as amended by the Act of February 13, 1925.

HENRY F. LONG,
Commissioner of Corporations and Taxation of the Commonwealth of Massachusetts,
By ARTHUR K. READING,
Attorney General of the Commonwealth of Massachusetts.
F. DELANO PUTNAM,
Assistant Attorney General of the Commonwealth of Massachusetts.

ALEXANDER LINCOLN,
Of Counsel.